We would like to thank the reader for his/her apt and constructive criticisms. We agree with all the comments without any exceptions and made substantive revisions along the lines suggested by the referee. Please see my point-by-point responses below - all in bold.

List of remarks:

1) It would greatly facilitate readability if the mathematical notation would be explained immediately when introduced. …. A clear definition of notation would certainly help here to avoid potential misunderstandings. To state the assumptions about the error term would also be helpful.

2) It is not really clear to me how equation (2) is related to equation (1).

Responses to comments (1) and (2): In the revised draft of the paper we clarified this issue. Specifically, we agree with the referee on equation (1) where we write a country specific time dummy variable along with the error term denoted by v_it. This equation belongs to an earlier version where we denoted the error term by v_t. In the current version, we only employ country level fixed effects in our estimation thus we have dropped s_ct from equation (1). We also mentioned our endogenous variables y_it. Since it is theoretically possible to include a set of covariates (x) in the Panel-VAR setting we also write x's separately in the methodology subsection. However in our actual regressions, we treat all of our variables endogenous.

Moreover, the referee is right in stating that the equation (2) is the demeaned version of equation (1). Following the suggestion made by the referee, we have denoted the demeaned variables with "tilde" in order to differentiate from the ones we have used in equation (1).

3) It appears to me that equation (4) is the logged version of equation (3). In that case, **K**t and **L**t in (4) should be logged. Moreover, if (4) is the logged version of (3), how do you enforce that \beta_1=1-\beta_2 ?

Response: We corrected the typo in equation 4. Moreover, we also mention in the text that we impose the constraint that \beta_1=1-\beta_2 when estimating the production functions.

4) In footnote 8 it is stated that the depreciation rate is assumed to be 0.08. Can you back up this assumption with empirical results/stylized facts, and is it reasonable to assume that the rate is the same in each country?

Response: A depreciation rate of 8 % is standard the RBC literature and is widely used when constructing cross-country capital stock series. To clarify this issue further, we now mention this also in the text.

5) I would recommend that the authors check the paper for typos and grammar. In

particular, there are several instances where a word is typed twice, where verbs are incorrectly conjugated, and where an article is lacking. Moreover, the reference list seems to contain some 'code' from an internal reference system. I have attached a pdf-file of the paper with some minor remarks on typos, etc.

Response: For the updated draft of the paper, we subjected the paper to several checks in order to avoid typos and errors. We also want to thank the referee for his/her time and effort providing us remarks on typos.

6) It would be good, if all the tables were self-explanatory. For example, Table 1 contains summary statistics such as mean values and standard deviations of five variables, but from the table alone it is not clear what units the variables are measured in. Table 4 is lacking a note explaining which levels of significance that are indicated by one, two, or three asterisks. It should also be stated what the numbers in parentheses represent. I assume, it's standard errors.

Response: All tables are self-explanatory in the updated draft of the paper.

7) The empirical finding that shocks to the wage-productivity gap do not have a significant effect on unemployment should be discussed in more detail, in particular since existing studies on this subject have found mixed results regarding the effect of the wage-productivity gap on unemployment. The authors could shed more light on this issue by providing a more extensive discussion of their results.

Response: We now discuss our empirical finding that shocks to the wage-productivity gap do not have a significant effect on unemployment as well as the place of this result in the existing literature.